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Belarus – a chance to convert past mistakes into new advantages

Belarus is often treated as 'terra incognita' even among its neighbors. Indeed, the development path of the country is severely distinct from other CEE countries. In terms of long-term growth, majority of transition countries during the last decade fell back upon the growth of TFP (total factor productivity, i.e. technology and efficiency) being accompanied with reasonable growth of capital. Belarus, in turn, secured its growth almost entirely due to accumulation of capital, while productivity gains were extremely poor, especially in tradable sector. This path became possible due to high returns on capital given a number of benefits delivered by Russia (cheap gas and oil, preferential access to the Russian market). This easy path made Belarus one of the growth leaders in 2000-s in the CEE. However, this growth was accompanied by rapidly progressing external imbalances, as low productivity transformed into low competitiveness of tradable Belarusian goods.

By the end of the decade, enjoyment of easy solutions played a low-down trick with the country: it has mostly exhausted the potential of capital-based growth strategy, although the expectations and habits of high growth preserved. Furthermore, in late 2008 and 2009 Belarus found itself involved into global contagion, which contributed to poor output growth. That time the authorities actually ignored structural challenges and resorted to active expansionary policies. Hence, since 2010 a skewness towards short-term priorities explicitly visualized in government's policy. In other words, the government tried to struggle against structural problems by means of short-term tools. The repercussions followed in 2011: Belarus suffered large-scale currency crisis (the devaluation of national currency was roughly triple). The devaluation formed a 'grace-period' for Belarus, as the price competitiveness of its exports improved, which was a chance to recover a balance between long-term and short-term priorities. But previous mistakes of expansionary policy were repeated, and nowadays the country again finds itself facing a fragility of macroeconomic equilibrium with the background of lack of growth potential. However, today's situation is different from those in 2011 in some aspects.

First, the currency crisis has generated a huge wave of inflation expectations and radically reduced credibility to monetary policy (visualized in extremely high share of deposits nominated in foreign currency, which is fluctuating around 60%). Actually, monetary policy fell into a trap and its effectiveness is extremely low. A similar story is about fiscal policy, which has not much room for a maneuver.

Second, the currency crisis triggered long-lasting cyclical recession. The lack of room and low effectiveness of economic policy tools cannot provide enough stimuli to the economy to pass this stage till now.

Hence, at the first sight economic prospects for Belarus are really ugly: poor growth potential, cyclical recession, low effectiveness of economic policy, fragility of financial market, and progressing external imbalance. This perspective implies that macroeconomic adjustment is inevitable. External borrowing is the only solution that allows avoiding new macroeconomic adjustment until now. Recent trends at European emerging markets (capital outflows, weakening output growth and depreciations of exchange rates) sharpen the challenges. Hence, most probably in near future the government will have to carry out such an adjustment. Otherwise, there are risks of automatic adjustment.

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As strange as it might sound, from a broader perspective this new situation for Belarus presents a chance rather than a threat. Majority of CEE transition countries nowadays experience an impact of reduced growth potential (for them it is associated with the lack of capital) along with cyclical challenges. And in majority cases there is a trade-off between policies stimulating potential growth and those stimulating demand. As for Belarus, it has accumulated a stock of capital that would allow recovering its growth potential if the country can advance its productivity. However, the latter may be provided rather rapidly through institutional adjustments basing on the experience of the other CEE countries. In other words, the untapped potential of the past may generate growth even in a depressed CEE environment. And there is one more piece of good news. Such kind of policies simultaneously will enhance demand, while standard economic policies currently cannot do so. Hence, for Belarus there is little if any contradiction between short-term and long-term priorities. Moreover, the government shows some signs of readiness to such reforms. So, there is a chance for an ugly duckling to mature into a beautiful swan. ■

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